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C O N F I D E N T I A L SECTION 01 OF 02 ANKARA 005641

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STATE FOR E, EB/IFD AND EUR/SE
TREASURY FOR OASIA - MILLS AND LEICHTER

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TAGS: [EFIN](#) [EINV](#) [EAID](#) [PREL](#) [TU](#)
SUBJECT: AMBASSADOR'S MEETING WITH MINISTER BABACAN

(U) Classified by Ambassador Eric Edelman. Reasons: 1.5(b,d)

[11.](#) (C) Summary: In a September 3 courtesy call, Ambassador urged State Minister Babacan to wrap up talks on the U.S. financial package quickly, stick to the economic reform program, and take concrete steps to resolve problems facing U.S. investors. Babacan said he had instructed his staff to communicate to U.S. Treasury his acceptance of the 18 month disbursement schedule for U.S. assistance, which should pave the way for early congressional notification and signing of the agreement. He agreed on the need to continue implementing economic reforms, and specifically emphasized the importance of meeting primary surplus targets for 2003 and 2004. Babacan acknowledged that foreign investment inflows were "negligible," and highlighted the government's efforts to streamline the foreign investment approval process. End Summary.

[12.](#) (C) Ambassador opened his September 3 courtesy call on State Minister Babacan by urging the Minister to accept the 18-month disbursement schedule for our financial assistance, so that the agreement could be notified to Congress and possibly signed during the September 22 Snow-Babacan meeting in Dubai. Babacan said he had just instructed his staff to inform U.S. Treasury that Turkey accepted both the disbursement schedule and the four-year grace period. With these issues resolved, he expressed hope the Administration could notify Congress right away. Babacan added that signing the agreement this month would send a positive signal, and would help ease continuing public concerns about whether the money was linked to Turkey's decision on contributing troops to the stabilization force. At the Minister's request, Ambassador agreed to advise Turkish Treasury once the notification went forward, and to ask Washington if we could provide the Turks with a copy.

[13.](#) (C) Ambassador noted that, despite disappointment over the March 1 vote on troops, the U.S. had a major interest in the success of Turkey's economic reform program. Although in the end the costs of the war to Turkey had been much less than some had anticipated, the announcement of the U.S. package had played a critical role in stabilizing Turkish financial markets.

[14.](#) (SBU) The key now, the Ambassador continued, was for Turkey to take advantage of the current "window of opportunity" by pressing ahead with the reform program. If the GOT completed the 6th IMF review on time, hit the 6.5 percent primary surplus target (here Babacan interjected "for 2004 as well as 2003"), moved ahead with scheduled privatizations, and resolved some of the problems affecting foreign investors, it would have a very good story to tell at year-end.

[15.](#) (SBU) Babacan said the program had achieved a lot, though there had been some delays. He explained that the 4th review had been delayed due to uncertainty over Iraq and difficulties due to the fact that a new government had just taken office. The 5th review had been delayed several weeks because the Turkish Parliament had insisted on studying and debating every piece of proposed legislation. This, the Minister asserted, was actually healthy, and resulted in better legislation. Aware of Parliament's interest, the GOT and IMF had set more "reasonable" deadlines for legislative action for the 6th review, leaving Babacan hopeful it would not be delayed.

[16.](#) (SBU) Babacan said the biggest issue for 2003 and 2004 is the budget. Fortunately, the Prime Minister fully supports hitting the fiscal targets, which is critical given that there are "at least 15 ministers who want to spend more." The Minister cited as an example of the government's fiscal

steadfastness its refusal to offer public workers a wage increase greater than 12 percent, which has tentatively been set as next year's CPI target. With Turkey's huge public debt stock, the Minister added, "we have no choice."

17. (SBU) Ambassador warned Babacan that he likely would encounter skepticism from U.S. companies during his U.S. roadshow next week. Although businesses are looking with interest at Turkey's economic progress, they remain concerned over the numerous business climate issues they see. As the Vice President used to tell foreign visitors, the first thing that U.S. executives are asked when they go to their boards with foreign investment proposals is "how are other U.S. investors faring?" In the case of Turkey, the answer to that question is that Motorola had been swindled out of \$2 billion, cola companies face discriminatory taxes, other companies face problems with sugar quotas and zoning questions, and our pharmaceutical companies suffer from the lack of data exclusivity. While these problems cannot all be fixed immediately, Turkey needs to begin resolving them. If it can do this, while continuing to make progress on the macroeconomic fundamentals, there should be lots of interest from foreign investors.

18. (SBU) Babacan acknowledged that FDI inflows were "negligible." The government, he said, specifically the Committee for Enhancing the Investment Environment (which he chairs), is working with the private sector to change things. The Committee meets regularly to discuss problems and propose solutions. Already it has drafted or partly drafted 21 pieces of legislation. Parliament has approved 7 of them, including a new FDI law and legislation that streamlines the process for establishing a new company. Babacan recalled that, several years ago, he had needed 10 weeks to gain Treasury approval for his European joint venture partner to transfer capital to Turkey. Under the new law, the number of steps needed to establish a new company had been reduced from 19 to 3, and the process could be accomplished in just one day. Fortunately, there is a consensus within the government on reducing bureaucracy and improving regulation.

19. (SBU) Another big issue, said Babacan, is taxation. Because Turkey has a huge informal economy that does not pay taxes, the government has had to impose a slew of additional taxes to raise revenue. This has contributed to Turkey having the most expensive gas and the 3rd or 4th most expensive industrial electricity in Europe. The GOT is now working with the IMF to determine how to shift at least some of the informal economy into the formal sector. so it can reduce tax rates, further improving the investment environment.

110. (SBU) Picking up on Babacan's reference to sound regulation, Ambassador stressed the importance of strong government backing for Turkey's independent regulatory boards. He reiterated the need for the GOT not only to pass new laws, but to take concrete steps to resolve problems facing existing investors. If, he said, the government began to address these problems, he would be prepared to travel to the U.S. to make the case for investing in Turkey. At this point, however, it would be hard to make that case, given the problems affecting so many major U.S. companies.

EDELMAN